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JOYCE

THE POLITICS OF PRIVATIZATION
IN
INDONESIA AND MALAYSIA

PAMELA JOYCE
JUNE 10, 1991
THE UNIVERSITY OF MICHIGAN
CENTER FOR SOUTH AND SOUTHEAST ASIAN STUDIES

THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT
FOR THE M.A. DEGREE IN SOUTH AND SOUTHEAST ASIAN STUDIES

PRIMARY READER: LINDA LIM
SECONDARY READER: GARY HAWES

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INTRODUCTION

In examining economic and political trends of the 1980's, the process of trimming down unwieldy, inefficient public sectors has preoccupied political and economic planners across the globe. Developing countries in particular have been forced to implement massive restructuring of their economies in the face of a rapidly changing economic world order, with little tolerance for inefficiency or waste. The need for economic rationalization is not surprising in light of the rapid, unrestrained expansion of the public sector throughout the 1970's. Floundering, debt-laden public enterprises have essentially outlived both their political and economic usefulness. Privatization, in part, represents a backlash versus the excesses created by protection, subsidies, and irrational non-economic objectives, which enabled the proliferation of uncompetitive industries under the guise of national development.

By definition, privatization calls for a reduction of the role of the state while enhancing the breadth of the private sector and accumulation of private ownership. Market forces rather than political interference and protectionist policies determine profit and viability. Yet the text book cases documenting this transformation within developed Western economies are often inappropriate and inapplicable within lesser developed economies, still in the process of industrialization. In many countries, economic efficiency and productivity have never been the predominant, overriding goals of economic policy. This is particularly relevant within the polities of Southeast Asia, where the line between political and economic activities is often blurred, and policies are characterized by multiple, interwoven objectives. If political and social objectives can be achieved in tandem with economic goals, all the better.

Though attempts to create rationality and transparency in the economic sphere constitute a current global trend in policy formulation, it is a unique process which cannot be removed from its distinctive political, social, and historical environment. The development of public sector expansion, followed by privatization, have each been perceived as timely necessary responses to the changing economic order. Yet the rationale behind these changes in policy within Southeast Asia, do not stop with economic justification. They often represent calculated political moves to protect the perpetuation of ruling interests and the viability of a political system which guarantees a disproportionate return to the ruling elites. In the 1980's, privatization represents the most effective means of legitimizing political ownership and control, necessitated by an altered international order where the old rules no longer apply. According to Indonesian economist M. Hadi Soesastro in discussing economic liberalization in Indonesia, ultimately "deregulation is a political process.....and as a political process, it defies rational explanation."[1] The intricate politics of privatization have made its implementation far from rational or transparent.

To understand the use of economic policy as a tool to complement and fulfill political objectives in developing countries, it is constructive to focus on common patterns of change which apply beyond the national boundaries of a single country. For the purpose of this study, the politics of privatization will be examined within the confines of Malaysia and Indonesia, as examples of trends progressing throughout the Asian region. As case studies, these two countries

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[1] M. Hadi Soesastro, "The Political Economy of Deregulation in Indonesia", Asian Survey, vol. XXIX, no. 9, September 1989, p. 863.

provide ample ground for comparison in their respective paths of economic development and rationalization by a political elite. By tracing the history of state involvement, the rise of the public sector, and the evolution of key linkages between the bureaucracy, military and business interests, the complex interplay of politics and economics is established as the motivating force behind policy formulation. Richard Robison, in his book The Rise of Capitalism in Indonesia, points to the state-owned corporate sector as the linch-pin of political dominance over the Indonesian economy.[2] Yet the conditions which set the stage for the effective use of public enterprise as a political tool are far from static; the transformation of economic conditions in the 1980's has necessitated the implementation of structural change and a corresponding reworking of the tools for maintaining political control and dominance.

The quadrupling of oil prices in the early 1970's impacted economic policy around the world, particularly in developing countries with access to a sudden windfall in oil revenues. Any incentive to curb growth without efficiency and correct protectionist economic policies was effectively suppressed. As a result of the oil boom, foreign banks suddenly possessed large reserves of petro dollars which they were eager to recycle in the form of loans. This, in tandem with high inflation and low interest rates, fueled high borrowing throughout the developing world. Indonesia used its loans primarily for infrastructure development in the natural resources sector. The economy became increasingly dependent on oil revenues, accounting for, at its peak, 90% of government expenditures. The development of non-oil exports was ignored in favor of

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[2] Richard Robison, The Rise of Capitalism in Indonesia, (Sydney, Australia, Allen and Unwin Ltd., 1986), p. 211.

an import-substitution industrialization program dependent on government protection in the form of tariffs and subsidies. A network of burdensome trade and investment regulations, coupled with increased nationalist sentiment, prevented foreign investment from playing a more significant role in the economy.

Malaysia borrowed heavily during this period in order to further nationalize its economy and reduce the level of foreign ownership. The government bought up controlling shares in a number of foreign firms, as part of its strategy for increasing Malay economic participation and ownership. Prime Minister Mahatir introduced the "Look East" policy in the early 1980's, using Japan as a model for heavy industrialization. This program required substantial financing through borrowing, representing a break from Malaysia's traditionally conservative macroeconomic management. In this environment, private sector expansion received little attention, as the role of public enterprise continued to expand in key economic sectors.

Flamboyant borrowing and spending came to a halt with the debt crisis of the 1980's, initiated by a host of international factors affecting loan repayment. The sudden drop in oil prices, coupled with the recession of the mid-'80's, appreciation of the yen, and increased interest rates did not bode well for countries bearing the escalating burden of debt payments. Due to the drop in commodity and oil prices, and rising value of the dollar, export earnings were no longer sufficient to cover these payments. These conditions fueled a sense of economic crisis which enabled the implementation of drastic restructuring measures. In the case of Indonesia, it was not until oil prices fell to $10 per barrel in 1986 that it became politically feasible to implement long debated reforms.[3] Deteriorating balance of payments provided the incentive for substantive deregulation of the economy.

In the words of Indonesian economist M. Hadi Soesastro, there exists "no guide to the proper sequencing of structural reforms in an opening (as distinct from an open) economy".[4] Yet both Malaysia and Indonesia did a remarkable job in rapidly responding to the economic challenges of the 1980's. Rather than waiting for economic stabilization, they simultaneously implemented restructuring measures to enhance economic efficiency, preserving financial stability while promoting growth. Both implemented austerity measures to stimulate fiscal and monetary contraction. Currencies were devalued and trade and investment laws were liberalized to attract much needed foreign exchange. In Malaysia, the New Economic Policy was liberalized to allow 100% foreign ownership. The growth of direct foreign investment enabled a shift from debt to foreign equity as the basis for promoting growth and development. Malaysia used this capital to rapidly repay its debt. In Indonesia, a conscious effort was made to diversify the economy away from oil exports; by 1988, revenues from non-oil exports increased from 10% in the early '80s to 48%, a substantial shift. A world wide currency realignment enhanced the competitiveness of exports on the world market and caused Japan and the NICs to look to Southeast Asia for offshore production sites, to stem the rising costs at home.

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[3] Mari Pangestu, "Economic Policy Reforms in Indonesia", The Indonesian Quarterly, vol. 17, no. 3, 1989, p. 222.

[4] Soesastro, p. 854.

It was not until access to funding from oil exports and loans was threatened, that a more transparent, international economic approach became a necessity. The state's inability to continue to finance and subsidize economic expansion led to the realization that increased efficiency within the system was a prerequisite for continued growth. Reform became the obligatory response to the altered economic environment of the 1980's. The implementation of restructuring measures fostered rapid growth and provided a taste for the rewards of greater technocratic management of the economy. Inefficient public sector enterprises heavily reliant on foreign borrowing and plagued by operating deficits were an obvious target in the move to enhance productivity and transparency. As traditional patronage and finance sources with both economic and political objectives, their dismantlement posed a direct challenge to customary foundations of power and the vested interests of the political elite. Left with few other viable alternatives, politico-bureaucrats have had to adjust accordingly their sources of revenue and their tools for maintaining political control within this new environment. Privatization represents one of these tools, and has been used in both Malaysia and Indonesia to boost indigenous economic ownership and to maintain the reigns of power in an environment where the old rules no longer apply.

A direct result of this economic transformation has been the growing predilection on the part of governments to move toward privatization of key economic sectors to enhance efficiency and competitiveness in an increasingly integrated world market. The process of privatization can be implemented in a variety of forms, dependent on the role of the state, the goals of public sector divesture, the impetus for structural change, and the existence of a developed indigenous capitalist class capable of taking over from the state. The net results of this process have been the emergence of a unique form of privatization "Asian style". Rather than a significant removal of state interference in the economy, Indonesia and Malaysia have experienced a transfer of economic patronage from the state to decentralized power centers made up of political elites and political parties. This transfer of ownership has been implemented cautiously, in an effort to preserve the viability of the regime and its social and economic base. Rational technocratic management of this transfer of ownership has been impeded and distorted when the business interests of politico-bureaucrats have been threatened by change.

Inherent differences in the distribution of patronage are engendered by the structure of the political system itself. In the democratic party system of Malaysia, it is the goal of the political elites to protect the position and assets of the party to which they owe power, which throughout the independence era has been the United Malay National Organization (UMNO). In the authoritarian, military-dominated state of Indonesia, the goal is to protect the position and assets of the ruler and military, and, as a political elite, create reciprocal patron-client ties which will guarantee political access and favorable treatment. The rapid, expansive growth of prominent corporate conglomerates and their respective nuclei of power is reflective of these variant political systems.

The impact of the political system and its players on the restructuring of the public sector must also take into consideration basic political motivations and underlying issues of legitimacy. Funding of the political machine, entrenchment of political elites as indispensable players in the accumulation of domestic capital, and the spread of the fruits of growth to a broader societal base all serve to enhance the long-term viability of those holding power. In both Indonesia and Malaysia, legitimacy of the state has been augmented by outstanding economic growth rates which have tempered public outcry versus the existence of political repression and economic inequality. The state has fashioned itself as an agent of growth, promoting goals of national development and bolstering the position of the indigenous Malay versus Chinese and foreign interests. Continued economic growth in tandem with decreased formal state ownership was targeted as an ideal answer to legitimation questions in the 1980's, brought to the forefront by earlier economic crisis. Privatization provided an easily manipulated means to this end, and a vehicle for initiating the reconstitution of the political power basis out of the presidential palace and into the market place.

HISTORICAL BACKGROUND: THE RISE OF THE STATE SECTOR

The complex interplay of factors affecting the rise of the public sector, the move toward privatization, and the political rationale behind this transition, requires a review of historical trends heralding the growth of state involvement in the economy. In both Indonesia and Malaysia, the economic development paths followed in the early days of independence were sharply influenced by their respective colonial experiences. The Dutch and the British used their profitable bases in Southeast Asia to extract high value commodity exports for sale on the world market. Their policies led to the creation of a dual economy, in which the modern export sector was dominated by foreign nationals juxtaposed by a traditional economic sector of subsistence agriculture, petty trade and handicraft production which remained the domain of the indigenous

Malay population. A growing Chinese community, able to tap into an extensive overseas trading network and capital base, developed as middlemen linking the modern foreign dominated economic sector with the traditional rural economy.

The transformation to an export oriented, cash crop economy progressed along more extreme lines under the Dutch in Indonesia than under the British in Malaysia. The Dutch relied on traditional power relations, using indigenous channels of authority as a means for economic extraction. This system resembled a form of dual, but not equal Dutch and native rule, in which Dutch administrators and Javanese regents presided over the ruling of the regency. The regent's authority was secured, yet his independence was lost to the Dutch.

The Dutch attempted to buttress the peasantry from the effects of rapid economic modernization and the transition to a market economy, through maintenance of traditional pillars of authority and culture. Yet the pressures of the new system permeated village life, as the rural population was forced to abandon traditional modes of subsistence farming and the primary cultivation of rice, in favor of growing foreign commercial crops with little use within a subsistence economy.

The passage of the Agrarian Law of 1870 changed the complexion of colonial economic policy in the Indies. The Agrarian Law effectively opened the islands to private capital and enterprise, allowing the Dutch to lease government lands for up to 75 years, and Indonesian lands for shorter periods. This paved the way for the development of large scale plantations, the growth of a cash crop economy and the use of foreign planters, capital, and labor.

This rapid evolution of a new social order contributed to the development of a plural society. The gap was widened between the planter and the laborer, as human value was increasingly measured in production terms. As the economic system was transformed from indirect economic exploitation to one of directly administered free enterprise, traditional cultural and political buffers were eroded, and the peasantry became increasingly vulnerable to world market fluctuations. The peasantry's opposition to the colonial system had traditionally been directed toward the proximate and visible symbols of colonial power, namely the Javanese aristocracy and the Chinese. These symbols served to mitigate the degree of peasant animosity vented toward the Dutch. These buffers eroded with the rise of the more invasive plantation economy.

In addition to the agricultural sector, the Dutch established and invested in a number of state enterprises, primarily in the public utilities domain including railways, postal services, electricity generation and oil and natural gas exploration. These enterprises were nationalized and subject to more centralized control under the Japanese during their occupation of Indonesia during World War II. The close interaction between government and enterprise administration provided a poor training ground for impressionable Indonesians, who were placed in managerial positions for the first time under Japanese aegis. This early exposure to management of the modern economic sector significantly influenced Indonesian predilections for a state guided economy. Concepts of competition and production for profit were absent in the training process.

Remnants of Japanese war time management practices are still visible today, as witnessed by the perseverance of target orientation versus efficiency.[5]

Not surprisingly, Marxist ideology found a receptive audience among the newly emerging Indonesian elite, due to it's anti-imperialist content. Nationalist sentiment adopted far more radical and revolutionary overtones as compared to the Malaysian case, reflective of their diverse colonial experiences. Any attraction to capitalism and private enterprise was effectively squelched in Indonesia due to its equation with colonial domination. Independence and capitalism were viewed as contradictions in term, further intensified by the Dutch attempt to re-claim its colony at the conclusion of WWII. Once independence was attained following a four year struggle against the Dutch, the founders of the Republic of Indonesia were committed to using state enterprise as the primary tool for rebuilding the economy, and embedded the state's interventionist role in the Constitution of 1945. Article 33 states that the "branches of production important for the State and of dominating interest to the livelihood of the masses of the people have to be controlled by the State."[6] History has proved this article is open to broad interpretation.

The British experience in Malaysia differed in several important respects, leaving in its wake a distinct economic and political framework incorporated by the Malaysians at

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[5] Mohammad Sadli, "The Private and State Enterprise Sectors in Indonesia", Indonesian Quarterly, vol. XVI/2, 1988, p. 206.

[6] Ibid, p. 210.

independence. Malaya's colonial occupation was far shorter and less invasive than that of Indonesia. The British exercised a light political hand, preserving the traditional ruling structure of the sultanate though significantly reducing its political significance. The Malay peasantry was intentionally buffered from the effects of a rapidly developing commercial economy, and excluded from participation in the lucrative plantation and mining economy developed by the British. While the peasantry maintained a traditional subsistence based economy, Chinese and Indian contract laborers were imported to work in the tin mines and on the rubber estates, forming the beginnings of an occupational specialization of the races which has persisted to this day.

As in the case of Indonesia, a modern export sector existed side by side with the traditional subsistence sector. Yet a careful network of paternalistic policies prevented the erosion of buffers in Malaya, shielding the economic and social system of the peasantry and protecting the legitimacy of the traditional aristocracy. Land reservations established by the British to ensure Malay ownership, effectively tied the peasantry to the land and preserved traditional rice growing patterns.

The development of commercial agriculture necessitated a shift from the traditional pattern of usufructuory land rights to the institution of land tenure, placing the British in control of land titles to be distributed in the name of the State government. This paved the way for the development of commercial rubber plantations and an influx of foreign investors eager to participate in the tremendous profits reaped on the world market.

The Malay aristocracy was given a greater stake in the colonial apparatus than its Indonesian counterpart through access to the civil service and administration. As the British presence in Malaya expanded, the traditional elites were increasingly drawn into the colony's administration, marking the beginnings of a longstanding alliance between the aristocrats and administrators within the local community. From the beginning, this elite remained part of the traditional political structure while simultaneously performing as civil servants. Malaysia's political leadership would eventually emerge from this pool of English educated administrators, with little concept of a politically neutral civil service.

Strong nationalist sentiment and revolutionary ideology targeted against the British, had little grounds for establishing a foothold in Malaya. The British were welcomed back as liberators, signaling the termination of a brutal Japanese occupation period. Independence, though longer in the coming, was achieved peacefully through a series of gradual transfers of authority, culminating in 1957. Rather than eschewing all vestiges of the colonial occupation, as in Indonesia, the founders of an independent Malaysia were both confident and comfortable with a British style bureaucracy and a capitalist economy. Predilections for state involvement in the economy had, as it basis, a very different motivation and rationale. State manipulation of the economy sought to correct the disadvantages suffered by the Malays as a result of British paternalistic policies, which had hampered modern development.

As a result of the prevailing sentiment at the time of Indonesia's independence, the state was poised for entrance into the economy as a substantial player. A strong sense of nationalism and a commitment to social objectives were incorporated into state ideology as legacies of the colonial occupation. The framers of the new Republic sought to reconstruct a national economy from a colonial past, using the political power of the state as a tool to alter the precedent of an extractive economic system. It was never the intention of these early economic planners to completely nationalize the Indonesian economy, but rather to incorporate a mixed formula, relying on public enterprise as an "agent of development".

Indonesian economist Mohammad Sadli sketches a hierarchical political pyramid as illustration of the colonial "status quo" the Republic's framers sought so fervently to place behind them. The pyramid is dominated by western enterprise, followed below by Chinese merchants and traders, who preside over the foundation of the pyramid, made up of the dominant indigenous Indonesians. The leaders of independence sought to redress this hierarchical imbalance, elevating the impotent majority through use of the state's assistance and protection. Sadli goes on to say, "Before a genuine indigenous modern private sector can develop, the public sector becomes the spearhead and bulwark of the emancipation process."[7] As such, an initial policy goal of Indonesia's state-led economy was to provide the necessary framework for private sector growth and capital accumulation.

Richard Robison, in The Rise of Capital in Indonesia, gives further credit to this theory. He points to the distinction that state capital in Indonesia did not emerge as a product of a

[7] Ibid, p. 208.

socialist revolution versus a capitalist class, but rather as a component of a nationalist capitalist revolution. State capital has not expropriated private capital, but has created the environment necessary for its accumulation.[8] It filled the gap for an absent domestic capitalist class at the time of independence.

In reviewing the pattern of state sector expansion in Indonesia, there are two identifiable groups of state owned enterprises which came into existence at significant moments in history. First, there were those established just after the formation of the republic, including the telephone company Perumtel, electricity utility PLN, and airport and railway administrations, patterned after the colonial model. The scope of the state sector remained small and ineffective during the early days of the Sukarno regime due to political instability which prohibited economic growth and gave rise to high inflation rates, low growth and investment, and alienation from the West. The degree of state penetration of the economy and capital ownership increased markedly in the late 1950's due to a political dispute with the Dutch over the status of West Irian. This disagreement led to the nationalization of all remaining Dutch enterprise, primarily in the areas of mining, plantations and foreign trade. This move was viewed by many as a necessary component of the decolonization process, and created an overnight expansion of the size and breadth of the Indonesian bureaucracy. Though the state's role in the economy is enshrined in the constitution, some have postulated that this substantial expansion of the public sector was largely an ad hoc response to the spoils produced by a political conflict. With the absence of an

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[8] Robison, p. 212.

indigenous capitalist class, the state had no choice but to fill the void and assume ownership.

During this same period, one of the most important and perhaps controversial state enterprises was founded, with the incorporation of a cluster of defunct oil wells in North Sumatra by a group of army officers into the national oil company Pertamina. With sole access to a vast and increasingly valuable commodity, Pertamina became the primary producer of revenue and foreign exchange earnings for the state. Rather than actually invest in the oil sector, Pertamina's primary function was to manage the resource through the allocation of contracts and production sharing arrangements with foreign investors. Protected by the Constitution which clearly states that energy resources belong to the state, Pertamina was viewed as a vehicle for national development based on extraction of a natural resource, and as such, was treated as an inexhaustible commodity. It has been censured for becoming a "state within a state", possessing a degree of independence which enabled it to defy state control of its operation and finances. Degree of independence, lack of accountability and role as a provider of surplus funds to the military have been standard criticisms directed at Indonesia's public sector.

Since the founding of the Republic, the state has consistently provided the greatest source of domestic capital for investment and growth. As the only significant indigenous funding source for large scale projects, the state also saw itself as a counterweight to Chinese and international capital, playing upon the strong nationalist sentiment of the era. The state, in its attempts to alter Chinese and foreign dominance of the economy provided protection and subsidies to indigenous players, yet high rates of failure and misuse of funds made this policy less than effective. The focus of state capital was directed toward development of key economic sectors, particularly natural resources and infrastructure projects, which were often unprofitable, providing no immediate investment return and little appeal to outside investors. Another fundamental goal, to create a self-sufficient industrial base to replace heavy reliance on commodity exports, began with the state's production of cement, textiles, glass, and automobile assembly. Control of strategic economic sectors would prove to be a valuable source of supplementary funds and patronage for political and military leaders, and a tacit underpinning of the military's long term involvement in the political arena.

The political and economic failures of the Sukarno era led to a crisis which destroyed political support of a nationalist, state-led industrialization policy, stimulating a shift in economic development strategy. The goal of national industrialization through sole reliance on state capital, proved ineffective and short-sighted. The beginning of Suharto's New Order heralded the return of international investors with the financial capacity to fuel Indonesia's transformation to an industrialized economy. Confrontation with the West was dropped in favor of needed foreign investment, loans and technology. Major state-funded industrial projects were discarded in favor of production of ISI consumer goods. The emergence of laissez-faire policies was short-lived. By the early 1970's the state began to play a more aggressive role in promoting and protecting domestic capital and industry. Development of large scale national industry responsive to central planning, able to take a risk and operate at a loss re-emerged, focusing on major resource projects in the areas of natural gas, oil, steel and aluminum. In the early 1980's, Minister of Industry Soehoed stated the key functions of the state owned corporation as follows:

to develop vital sectors in which the capacity of private investors is limited; to participate in important commodity ventures to stabilize prices; and to pioneer new sectors of enterprise in which the risks for private enterprise are still too great.[9]

The renewed appeal of state-led, economic nationalism was significantly fueled by the rise in the price of oil. The infusion of oil earnings into the state coffers effectively freed the state from dependence on foreign capital, and led to the abandonment of technocratic efforts to recast the economy along more competitive, market based lines within a legal regulatory framework. The oil boom fueled growth without efficiency and the rapid expansion of the public sector. By 1985, the combined sales from state enterprises accounted for 30% of the country's GDP.[10] Any effective incentive for reform of high cost, inefficient public enterprises was lost to a funding source which enabled irrational growth and required no accounting of expenditure. This would continue until the plunge in oil prices necessitated a restructuring of economic policy.

State capital, from the outset, was invested in strategic sectors of the economy. Ownership remains concentrated in four primary areas, namely resources, infrastructure and utilities, manufacturing, and the distribution of basic commodities. Resources have historically occupied the most important economic sector because of their role as a major foreign exchange

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[9] Ibid, p. 223.

[10] Djisman Simandjuntak, "Indonesia's Economic Development: Recovery After Deregulation", Indonesia Quarterly, vol. XVI, no. 4, October 1988, p. 228.

earner and provider of revenue for state coffers. Pertamina, Inhutani (forestry), Timah (tin mining), and Aneka Tambang (general mining) are key public enterprises which the state has used to establish production sharing agreements with foreign companies. The primary function of these enterprises has been to collect taxes and royalties, and allocate concessions, while foreign partners have taken responsibility for the bulk of investment and production. The utilities sector is dominated by PUTL (public works), P.T. Telkom (telecommunications), and Perusahaan Listrik Negara (electricity) through which the majority of state investment in national infrastructure has passed. The manufacturing sector was developed and expanded to promote national industrialization and has tended to focus on larger, more capital intensive industries such as steel and ship building.

The state has also been heavily involved in the distribution of basic commodities. The primary player has been Bulog (Badan Urusan Logistik Nasional - National Logistics Board) established in 1967 as a vehicle for the state to maintain control over the pricing and distribution of basic staples, especially rice, sugar and flour. It has filled a political role, through its ability to control shortages and price increases of staple foodstuffs by ensuring stable price and supply. Through its control of distribution and ability to allocate contracts, Bulog has also been an important source of patronage and funds. In the early 1970s, severe domestic rice shortages occurred due to Bulog's failure to make necessary overseas purchases. In other years, rice was imported when ample domestic supplies went unpurchased, evidence of ineffective management and the ease to which Bulog fell victim to corrupting patron-client influences. In these sectors where state capital remains a primary player, the government has attempted to instill greater competency within management ranks and eradicate those practices most open to patron-client abuse. However, regularization still requires substantial improvement.

In Indonesia, the colonial legacy had a far more reactionary impact on the implementation of economic policy. Malaysia, comfortable with its capitalist and bureaucratic orientation adopted from the British, was influenced by a different set of criteria for embarking upon a state-led economic development program. As a result of colonial economic policy, Malaysia inherited at independence a far more ethnically diverse and divided population. The significant Chinese economic position, though more substantial than Indonesia, was largely accepted in return for bumiputra (indigenous Malay) political control through the dominant United Malay National Organization (UMNO) party, and the power to politically engineer a greater piece of the economic pie for the Malay population if necessary. From the outset of independence, Malaysia followed a laissez-faire, free market approach based on the diversification of primary product exports to the world market. Though the economic sector was dominated by Chinese and foreign capital, the Malays were given few special privileges in an attempt to allow an open, competitive market. This approach perpetuated the ethnic occupational specialization begun by the British.

By the late 1960's, bumiputra willingness to accept the growing economic gap between themselves and the Chinese was growing thin. Malay corporate ownership had increased by a negligible amount during the first decade of independence, gaining less than 1/3 of the increase of GNP while accounting for 1/2 the total population.[11] The state itself was suffering a legitimacy crisis: the non-Malay population viewed the state's policies as impartial and preferential toward the Malays, while the Malays were unhappy with the free market, laissez faire policy which gave a disproportionate economic return to the non-Malays. This discontent was aggravated when, in 1969, the Malays suffered an electoral setback in the key state of Selangor, losing seats to the Chinese opposition. Race riots broke out in Kuala Lumpur, shaking the confidence of the Malay government, and stimulating suspension of the constitution and a change in leadership.

The government viewed this outbreak of violence as manifestation of bumiputra discontent over Chinese economic dominance, and sought to take a more active, interventionist role in the allocation of economic resources to the Malay through use of public sector enterprise. Capital ownership, management and control would be restructured to more accurately reflect the ethnic composition of the population. The New Economic Policy (NEP) emerged as the government's tool for instigating an economic and social transformation of Malaysian society with the stated objective of fostering national unity and integration. This was to be achieved through employment creation and growth to eliminate poverty; and the eradication of identification of economic function with race. Restructuring the economy through growth, rather than expropriation of foreign or domestic non-Malay capital ownership was an important underpinning of this plan.

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[11] Just Faaland, Growth and Ethnic Inequality: Malaysia's New Economic Policy, (London, Hurst & Co., 1990), p. 38.

Laissez-faire policies had failed to bring about a necessary societal transformation; the NEP was a sign of the government's admission of this failure and an indication of its new interventionist role in the economy. The objectives of the NEP were formally incorporated in the constitution and outlined in the Second Malaysian Plan (1971-75), which stated:

> The NEP is designed to ensure that the government is sufficiently equipped to influence the pattern of economic growth in directions which will bring about a more equitable sharing of the benefits of growth and development among all Malaysians. [12]

This plan called for a restructuring of assets to ensure 30% bumiputra ownership of total commercial and industrial activities by 1990, striving for proportional participation of all ethnic groups in all economic sectors. As in the case of Indonesia, the state sought to create a viable indigenous commercial class to compete with Chinese and foreign capital. The establishment of public enterprises became the primary vehicle for attaining this goal. These enterprises, in tandem with the protection of quotas, access to government contracts, ownership and employment requirements in foreign joint ventures, and favorable credit, training, and land acquisition opportunities, formed commercial entities capable of competing with previously unchallenged Chinese monopolies.

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[12] Ibid, p. 80.

The primary entities formed to attain these goals were Perbadanan Nasional (PERNAS) and the Urban Development Authority (UDA). Before delving into the function of these enterprises, mention should be made of the entity Majlis Amanah Rakyat (MARA) established in 1966 prior to the formulation of the NEP. MARA's mandate was to "promote, stimulate, facilitate and undertake economic and social development in the Federation and more particularly in the rural areas."[13] It was given greater power than its predecessor, the Rural and Industrial Development Authority (RIDA) to develop commercial and industrial enterprises, and the focus of its projects rapidly shifted to the urban areas. As the brainchild of a powerful Malay politician anxious to gain the support of the poor Malay electorate, it was subject to political influence, financial abuse, and accusations that it benefitted UMNO supporters. Due to its independence and well established patterns and connections, MARA did not lend itself towards the new development policies of the NEP. In the 1970's, it was reorganized in order to more closely complement national development strategy.

PERNAS, established in 1969, became the largest and most successful government tool for achieving the objectives of the NEP. Its goal was to establish government owned commercial operations which would increase bumiputra ownership in industry to 30% by 1990. The state learned from MARA's failures and steered away from the strategy of financing bumiputra entrepreneurs from scratch. Rather, PERNAS relied on already established, successful businesses in growth industries to establish its objectives. Through joint-ventures and the use of foreign

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[13] Bruce Gale, Politics and Public Enterprise in Malaysia, (Kuala Lumpur, Eastern University Press, 1981), p. 51.

managers, these new government owned bumiputra companies attempted to shield themselves from more invasive patron-client influences. Investments tended to focus on plantation and mining ventures.

In tandem with PERNAS, the UDA was established in 1971 to further implement the NEP's restructuring goals by aiding Malays to establish themselves in the manufacturing, retailing and service sectors of the economy. This was primarily accomplished through the provision of commercial office space in Chinese dominated urban areas. The UDA's mission was, from the outset, the most ethnically charged, as it actively promoted Malays to compete with the Chinese. Both the UDA and PERNAS fell victim to financial mismanagement, a lack of accountability, and abuse by Malay businessmen. These examples provide evidence of the limitations of solely relying upon state enterprise to attain social and economic goals.

From the outset, social objectives of more equitable distribution of capital ownership, and greater racial cohesion and unity formed the primary goal of the NEP's use of public enterprise expansion. In Indonesia, social objectives were not featured as predominantly, taking a back seat to economic goals of industrial growth and development. The primary impetus for state control of strategic economic sectors varied, as reflection of the countries' variant political and social environments.

In both Indonesia and Malaysia, public sector expansion altered the nature of power sources and relationships, entrenching the authority of the state and political and military elites.

The benefits reaped through controlling the means of production would prove addicting, and increasingly difficult to relinquish as they became an institutionalized part of the system. The earliest evidence of this shift can be seen in Indonesia with the rapid expansion of the military's involvement in the economy, most notably following the nationalization of Dutch enterprise in 1957. These businesses were placed under the direct management of the army and quickly became valuable sources of extra-budgetary funds to supplement the military's coffers. The military's access to a substantial resource base provided ample opportunity for corruption and personal aggrandizement. The lack of administrative oversight and accountability further heightened the attractiveness of siphoning funds for both military and personal profit.

Initially, these state enterprises provided a funding base for the military otherwise unavailable from a taxed government treasury. It is speculated that the military's formal budgetary allocations routinely covered 50% of actual expenditures.[14] In the absence of sufficient government funding for defense and security, the military learned to rely upon state enterprises such as Pertamina and the rice trading agency Bulog, among others, as a source of revenue and patronage. Unsupervised control over these agencies provided the ideal conditions for the accumulation of vast amounts of wealth, and an independent power base for the military and its members free of bureaucratic controls. Any chance these enterprises had for becoming viable, profit generating entities was squelched by the military's early reliance upon them as supplementary funding sources, sapping them of efficiency and accountability. These activities

[14] Robison, p. 256.

developed a commercial orientation within the military which has left an indelible mark on the nation's economic structure.

The state's ability to provide adequate funding for the military became a reality in the early 1970's with the oil boom and sudden rise in export revenues. However, the military's reliance on public sector enterprise for supplementary funding had already become an institutionalized "perk", and in the words of political scientist Harold Crouch, "old fund-raising practices continued, partly because of the vested interests associated with them."[15] Few were willing to give up their extensive network of privileges.

Implementation of "rational" economic policy was impeded by the increasing involvement of the military in the economy. Policies were distorted and manipulated if they ran counter to the business interests of the military, allowing the proliferation of inefficient, high-cost public enterprises not subject to regular technocratic oversight. The failures of both Pertamina and Bulog in the 1970's are tangible evidence of the rampant corruption and mismanagement which plagued efficient operation of the public sector. The use of Pertamina as a source of revenue through the allocation of oil concessions and collection of oil taxes represents the most glaring example of the military's abuse of the public sector. Until its collapse in 1975, Pertamina was essentially run by one man, Colonel Ibnu Sutowo, free of all technocratic "interference". Even the spectacular financial debacle suffered by Pertamina at the hands of the military, totaling more

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[15] Harold Crouch and Zakaria Ahmad, eds., Military-Civilian Relations in Southeast Asia, (Singapore, Oxford University Press, 1985), p. 67.

than $10 billion in debt, did not fully reverse the trend of technocratic management exclusion. Bulog's failure to provide a sufficient national rice supply in 1973 led to the removal of its military director, yet corruption and irrational management persisted. Old habits die hard, especially when their death poses a direct challenge to the power and patronage base of an entrenched elite.

New public sector enterprises established to promote the goals of Malaysia's NEP created fertile centers for expansion of political elite influence and resources. In contrast to Indonesia where the military was the key beneficiary from the growth of the public sector, political factions, particularly within the ruling UMNO party were the primary winners in Malaysia. With access to a constant, dependable resource base, new patronage networks linking economic and government structures began to develop, changing the character of traditional politics. The strong bureaucratic and parliamentary tradition inherited from the British had largely served to keep this type of patron-client network in check, yet with the creation of these new power centers, access to new sources of funds and patronage proliferated, fueling the formation of informal, mutually beneficial relationships.

UMNO leadership was able to balance their avowed role as promoters of social development and change, as stated under the NEP, while simultaneously enhancing their political staying power through the accumulation of wealth and influence. For the first time politically powerful owners of equity emerged from the ranks of the party apparatus. This new found resource base provided political leaders with a degree of independent legitimacy and support.

The rise of the public sector's central role in economic planning has meant the further accumulation of power in the hands of the executive branch and federal government versus the legislature and state government. Within the UMNO structure, this process manifest itself through the concentration of power in the party's top tier.[16]

The NEP has offered an umbrella of protection for the use of public enterprise as resource and patronage centers. The NEP's interventionist approach rationalizes the state's active role in the promotion of economic redistribution. Public enterprise is an accepted instrument of national policy for promoting the greater social and economic good, and as such, has lent a degree of legitimacy to its use by individuals and political parties as a supplementary power base. Though both owner and manager of public enterprise, the state is acting on behalf of the bumiputras in gaining for them a more equitable economic share, and has not sought to develop its own independent power base.[17] Critics, however, maintain that a by-product of the NEP's focus on ethnic issues has been to bolster the position of politically connected, yet economically incompetent individuals who have used the plan to achieve personal ends. The redistribution of wealth to lower-income Malays, additionally an important sector of the electorate, has been complicated by the existence of this elite.[18]

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[16] Gale, p. 197.

[17] John Taylor & Andrew Turton, eds., Sociology of Developing Societies: Southeast Asia, (New York, Monthly Review Press, 1988), p. 20.

[18] Doug Tsuruoka and Michael Vatikiotis, "Finding a Focus", Far Eastern Economic Review, May 16, 1991, p. 60.

The justification of the state's active economic role by the NEP, in accordance with a legal regulatory framework, is an important point of difference in the ramifications of public sector expansion in Indonesia and Malaysia, and reinforces the importance of examining economic policy within a political framework. Though both states have been described as patrimonial in character, this tendency has been tempered in Malaysia by its democratic political system, and the power of the vote to enforce a greater degree of accountability upon its political and economic players. Malaysia has been described as possessing strong political institutions in tandem with weak patrimonial structures, while Indonesia mirrors the reverse tendency towards weak political institutions and rampant patrimonial and patron-client structures. The Indonesian model provides fertile conditions for the state to develop a more independent power base. However, phenomenal economic growth in both countries over the past two decades has perhaps blurred these distinctions. The creation of a greater amount of wealth for distribution, and the expansion of the pool of individuals with access to these resources, may deflect attention from the state's perceived clientelist, patrimonial tendencies if there is sufficient "trickle down" gain to expanded segments of the populous.

While the Indonesian state was characterized from the outset by patrimonial tendencies in which political power determined economic power, the Malaysian state initially adhered to a British bureaucratic model of strong political and administrative institutions free of outside interference. The constitutional changes instituted under the NEP in the early 1970's marked the beginning of a reappearance of patrimonial characteristics within the state, previously squelched during the colonial era by the British. Political debate was restricted, bureaucratic and political processes were made less transparent, political decisions were concentrated at the highest leadership levels, and the ability to dispense patronage to supporters increased, fueled by the proliferation of public sector enterprise. The NEP provided opportunities for the expansion of factionalism within the party structure and the spread of patron-client networks, as well as defense for their protection. This shift to a more participatory, interventionist role for the state was in direct opposition to the colonial precedent of limited government involvement.

EVOLUTION OF LINKAGES AMONG KEY ECONOMIC GROUPS

The key players in national economic growth have evolved along starkly divergent paths in Indonesia and Malaysia due largely to the state's perceived mandate in fostering development. In Indonesia, the fundamental component in this process has been the evolution of linkages binding the economic interests of the military, the ruling family, and Chinese and foreign capital. Interaction between these groups has created a common terminus of vested interests, linking state power with needed non-indigenous capital. This combination of access to patronage and capital has inspired a level of growth which might otherwise have been unattainable, and has molded strategy and commitment to economic development. This is in contrast to the economic development path pursued in Malaysia which has been influenced overwhelmingly by the socio-political goals of the NEP. As a result, the forging of an effective alliance between state and Chinese capital to enhance economic development was not a viable option. Because of the continued large scale foreign participation in the economy following independence, in contrast to Indonesia, the state was able to rely on foreign capital as an alternate, politically safer investment source to Chinese capital. These linkages, or lack of them, deserve special consideration in understanding the players determining public sector expansion and the eventual rationale for privatization.

The groundwork for the complex interplay of state and private interests in Indonesia began before the birth of the Republic. At independence, Indonesia already possessed a successful, entrenched Chinese trader community, connected to a well developed credit and distribution network spanning Southeast Asia. Clandestine relationships with members of the military to assist in extra-budgetary funding efforts began during the revolutionary period and continued through the Sukarno era, signaling the beginnings of a mutually lucrative alliance. Early attempts by the state to hamper the entrepreneurial success of the Chinese through regulation often backfired. In an attempt to overcome Chinese monopolies and bolster the development of indigenous capital, the government implemented the Benteng program in the early 1950's, distributing import licenses to over 5000 indigenous Indonesians. The majority of these licenses were quickly sold off by the recipients to Chinese traders possessing greater experience and capital, undermining the program's objective to develop an indigenous entrepreneurial class. The Chinese monopoly position was enhanced through access to a greater number of licenses, increasing their ability to permeate key sectors of the economy. Throughout the period, the Chinese continued to cultivate their relations with the military as financiers of mutually profitable, protective economic endeavors, and were well placed to take advantage of expanding economic opportunities. Labeled the cukong system, this expanding network of business arrangements linking Chinese business men with military officers has blurred lines of division between public-private and military-civilian sectors.

In tandem with Chinese economic expansion, the scope and function of the Army was undergoing expansion to include both military and socio-political functions. The Army, because of its role in the fight for Indonesia's independence, always felt it had a greater stake in the Republic beyond matters of defense and security. It never viewed itself as an apolitical organization, and sought to formalize its expanded, non-military role through the concept of the 'Middle Way', articulated by General Nasution in 1958, calling for the armed forces participation in all areas of political and social life. With the public proclamation of the army's augmented position, came a more rapid and open display of involvement in private enterprise and exploitation of military office for personal profit. Local Chinese and, with the beginning of the New Order in 1965, foreign investors, provided members of the military with much needed skill and capital while the officers in return provided access to licenses, contracts and concessions, as well as immunity from standard bureaucratic regulations. Military officers became highly sought after as joint-venture partners, able to make or break the success of an enterprise. This process intensified with the New Order's shift to a pro-active role in attracting foreign investment. Military officers increasingly benefited in their comprador roles as local partners to foreign investors, providing little more than access to a convoluted bureaucracy.[19]

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[19] Crouch and Zakaria, p. 69.

From the outset, the military's economic muscle was dependent upon political influence rather than entrepreneurial ability. Its early and substantial entry into business, meant the military itself became a center for capital accumulation, creating an unhealthy degree of independence and incentive to protect the viability of unprofitable domestic businesses. The Chinese, as financiers of the military's expanding investments, gained political protection. Increasingly in the New Order period, their value as an economic asset was recognized, and their capital and skills were put to use to revitalize the economy.

The proliferation of these ties linking the government, military and Chinese have had significant implications for patterns of growth, distribution and patronage. On the one hand, some claim the cukong system has lent a degree of stability to the regime, fostering cooperation for mutual benefit rather than competition among these groups. The state and military, in their integration with Chinese and foreign capital have formed a center of common vested interests, linking economic and political power in a manner not previously witnessed in Indonesia. As capital accumulation continues among the political elite, this constitutes a trend away from reliance on traditional modes of power. Increasingly, members of the military and Suharto family are becoming legitimate economic players, providing a basis of power which transcends the presidential palace.

On the other hand, this multifaceted alliance has been criticized for its blatant disregard of technocratic efforts to 'regularize' the economy and promote more balanced economic growth. The perpetuation of protected public sector enterprise, as a tool of national industrial policy, fostered production along inefficient, non-competitive lines. As patronage and power centers, little incentive existed for their dismantlement. In addition, pribumi businessmen have resented the special treatment the Chinese have received and feel entrepreneurial activity has been stifled, through the proliferation of conglomerates and subsidies, preventing competition by smaller players. Though the Chinese make-up only 4% of the nation's 180 million inhabitants, they account for two-thirds of all private economic activity.[20] From a political standpoint, some feel the military has been able to maintain dominance of the political system, precisely because Chinese economic dominance has prevented the development of an indigenous bourgeoisie, capable of challenging military rule.[21]

The Indonesian government has been disinclined to institute compulsory requirements for wealth redistribution along the lines of the NEP, for fear this might exacerbate rather than facilitate cooperation among ethnic groups. In light of national sensitivity over race, the government has chosen not to make an ethnic distinction, and instead describes its efforts as promoting "weak economic groups". If ethnic economic disparities continue to widen, and a dearth of capable pribumi businessmen continues, some believe Indonesia will have no choice but to implement an NEP-style system.[22] In the meantime, the government has chosen to promote less invasive measures to overcome these disparities. Beginning last year, President Suharto "suggested" Chinese-owned conglomerates divest up to 25% of their holdings to cooperatives.

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[20] Adam Schwarz, "A Piece of the Action", Far Eastern Economic Review, May 2, 1991, p. 39.

[21] Robison, p. 320.

[22] Schwarz, p. 40.

By early 1991, 105 companies had followed this request, yet the majority sold less than 1%, giving little hope the scheme would significantly alleviate economic disparities. The most recent government attempt to promote pribumi business has been dubbed the "linkage program", coupling smaller indigenous businesses with larger Chinese conglomerates, providing pribumis with access to training, capital, and opportunity. 10,000 companies have thus far been identified, and 200 have volunteered to participate as potential "foster fathers" for small and medium sized pribumi firms, with the Ministry of Industry serving as matchmaker.[23] It is too early to predict how this new scheme will fair in lessening the widening income gap between ethnic groups.

There is also a political element to be considered. Though the government publicly supports increasing pribumi capital ownership, a potentially powerful, autonomous business class with political clout to rival the status quo may prove to be a deterrent to government support. Conversely, ethnic Chinese businessmen, representing only 4% of the population, pose no such political threat. However, their ability to stir indigenous discontent over income disparity must be factored into the equation.

The absence of ties binding Chinese business and state economic interests has played an equally important role in the development of Malaysia's national economy. At independence, both Chinese and foreign capital occupied a dominant position in the economy. The Chinese presence was greatest in the trading and mining sectors, due to the prohibition during the colonial

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[23] Ibid, p. 39.

period of migrant land ownership and civil service employment. The British, with their paternalistic policies intended to shield the Malays from the development of the modern economy, effectively established a precedent for protection of the Malay versus Chinese competition. The large percentage of foreign ownership in the economy received favorable treatment by the newly independent government, a move that has been interpreted as a reflection of Malay insecurity toward Chinese economic dominance. Scholars have argued that foreign capital was more manageable politically, and thus preferable to reliance on the Chinese.[24]

From the outset, the Chinese in Malaysia have had a more independent power base than their counterparts in Indonesia. Representing one third of the total population, with access to political expression through the right to vote, the Chinese have constituted a significant voice which the Malay majority could not ignore. Malaysia's more open economic and political system removed the need for the Chinese to forge alliances for the sole purpose of economic survival, i.e., gaining access to licenses and concessions. Conversely, survival in Indonesia has required a degree of assimilation and protection by a powerful patron, two trends which have not characterized Chinese development in Malaysia. It should be noted that the military, which has played such a key role in the growth and protection of Chinese capital in Indonesia, has, as an apolitical institution in Malaysia, played no such corresponding function.

With the founding of the Republic, the Barisan National was established, bringing

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[24] James Jesudson, Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia, (Singapore, Oxford University Press, 1989), p. 56.

together a diverse collection of political parties comprised of Malays, Chinese and Indians, reflecting the nation's disparate ethnic make-up. From the outset it was a political alliance founded on compromise: unity was based on the understanding that non-Malays would be allowed to dominate the economy in exchange for the continuation of Malay dominance over the political realm. Thus emerged the laissez-faire economic environment which characterized the period from 1957-69. Chinese and foreign business flourished in these conditions, while simultaneously hastening the ethnic polarization of Malaysian society by increasing economic disparities.

However, this changed markedly in 1970 with the introduction of the NEP and a move towards employment of the state apparatus to correct economic imbalances among the ethnic groups, in response to the discontent of economically marginalized Malays. The abandonment of laissez faire policies and the adoption of an active role by the state in promoting Malay wealth and employment, meant the Chinese had to develop more creative ways to work around increasingly convoluted restraints. The state turned to multinational companies as a means to further political goals, linking Malay employment and ownership requirements to MNC operation in Malaysia. According to Malaysian scholar James Jesudson "as the state carried out its restructuring goals, multinationals helped to keep the economy afloat by absorbing labor and providing ownership opportunities for Malay interests in manufacturing."[25] However, the policy of redistribution through growth could not have succeeded without the injection of Chinese capital into the economy, in the absence of a developed indigenous capitalist class.

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[25] Ibid, p. 166.

The ramifications of the NEP have meant that, rather than collaborating, the Malay political elite and Chinese business have followed divergent economic paths and have ultimately been working at cross purposes. The politics of ethnicity have often overridden economic rationality and inhibited the forging of an alliance between political and economic power. Conversely in Indonesia, the state (more accurately the military and Suharto family) used Chinese economic power to develop its own financial base. In Malaysia the state relied more heavily on foreign capital, and has in the 1980's sought to transfer economic patronage to the ruling political party UMNO through privatization of state companies, in an effort to legitimize its growing economic holdings.

Malaysia's Chinese, far from being nurtured and protected as cukongs to powerful patrons as in Indonesia, have had to overcome institutionalized prejudices on a grander scale. Some have postulated this has forced greater competitiveness, resourcefulness, and independence in Chinese efforts to surmount government barriers. It has also meant they have tended to take a shorter-term investment perspective and have focused on safer financial returns.[26] In the face of economic stagnation in the mid-1980's, the state relaxed restrictions on overseas investment to stimulate the economy. The acquisition of capital by the state, whether it be overseas Chinese or foreign, superceded a number of the NEP goals in order to stimulate growth and development. However, economic crisis was not significant reason for the state to refute a 20 year old policy

[26] Ibid, p. 151.

and cast aside the foundations of the NEP to collaborate with the domestic Chinese. Currently, record breaking levels of foreign investment, fueling growth of one of the fastest expanding economies in the world, may effectively remove the need for adoption of a more accommodating policy toward local Chinese capital. It remains to be seen whether Malaysia's outstanding economic growth rates in the late '80's will affect the government stance on future cooperation, and what aspects of the NEP will be perpetuated beyond its extended expiration date this year.

PRIVATIZATION ASIAN-STYLE

In the strict, some say western sense of the word, the term privatization refers to the transfer of ownership and decision making from the public to private sector, thus reducing the role of the state and enhancing the influence of market forces. Yet if this definition is applied to the processes occurring within the economies of Malaysia and Indonesia, privatization would appear to have a far narrower scope than it actually does. If "full" privatization is defined as government divestment of 100% of equity, then barring Japan, not a single major Asian state enterprise has been wholly privatized.[27] It is necessary to expand this definition to incorporate a number of alternate methods which have been employed to lessen the state's hand in the economy. These include the transfer of ownership, the transfer of production, and deregulation of the economy, namely liberalization of government regulations interfering with market forces. There have also been increasing efforts to make the remaining public enterprises more transparent

[27] Matthew Montagu-Pollack, "Privatization: What Went Wrong?", Asian Business, August 1990, p. 32.

and accountable. The state in Malaysia and Indonesia has relied on a mix of the above in its effort to reduce its economic role and increase private sector participation. Privatization of public enterprise provides the most tangible means of measuring ownership transfer to the private sector, is the purest form of government divestment and represents a sign of strong commitment on the part of the government to privatization. Thus, for the purpose of this study, discussions of privatization will focus on the divestment of public enterprises and the actual degree of transfer from public to private sector.

The stated objectives of privatization programs in both Malaysia and Indonesia have focused on reduction of financial strain on the federal budget, and overall size of the public sector; promotion of competition, efficiency, and productivity in a changing economic climate; and acceleration of economic growth through the increased participation of the private sector. In Malaysia, poor financial planning and management has meant the loss of billions of dollars by public enterprises including Bank Bumiputra, Kedah Cement, and the Urban Development Authority. By the mid-80s, public enterprises were responsible for 1/3 of total public sector debt and 30% of total debt servicing.[28] In 1989, a government audit conducted in Indonesia indicated that of 189 companies in which the government held a majority stake, 2/3 of them were determined to be financially 'unhealthy'.[29] However complaints arose quickly regarding evaluation criteria, from among others, the Ministry of Mines and Energy, which faced a

[28] Edmund Terrence Gomez, "Malaysia's Liberalization is Skin Deep", The Asian Wall Street Journal, May 20, 1991, p. 14.

[29] Adam Schwarz, "A Lame Duck Hunt", Far Eastern Economic Review, November 23, 1989, p. 72.

particularly poor audit with seven of the ministry's eight companies classified as unhealthy, including Pertamina and electricity utility PLN. Critics claimed the parameters for evaluating the health of companies must take into consideration the fact that many of them operate with explicit social and economic development goals, often incompatible with the profit motive. According to one Pertamina official, "We cannot be measured against normal levels of profitability. Our corporate mission is different."[30]

Just as public enterprise has been used as an instrument for promoting social goals rather than economic growth, privatization of these enterprises has meant the perpetuation of strong social objectives in tandem with more straightforward economic goals. The pursuit of socio-economic targets is most blatantly apparent in Malaysia, where privatization has been used as a means for achieving the restructuring objectives of the NEP. The NEP's goal of shifting 30% of the country's corporate wealth to bumiputra ownership was a motivating force behind the rise of the public sector in the 1970's, and represents a significant force behind privatization efforts in the 80's and 90's. The National Equity Corporation (PNB) has been a primary vehicle for attaining this objective through its purchase of shares of both private and public Malaysian companies with high growth potential to be held in trust for eventual sale to the bumiputra community. One third of bumiputra capital ownership is held through trust funds such as the PNB, as distinct from individual holdings.[31] As a trust fund, the PNB provides a collective

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[30] Ben Davies, "Letting in the Light at Pertamina", Euromoney, December 1989, p. 68.

[31] Faaland, p. 234.

source of capital through which bumiputras can exercise influence. Though classified as a commercial venture, it remains answerable to the government. The government thus remains a key player in this scheme, and has been criticized for stifling private entrepreneurship and promoting a program which is in direct conflict with the goals of privatization.[32]

Within this setting, the most prevalent modes of privatization have been those involving ownership, primarily in the form of new listings on the stock market, and those involving organizational and operational change, such as the disbursement of contracts and leases to the private sector and the formation of holding companies with private subsidiaries. In the interest of an open and efficient transition from public to private ownership, listing on the stock exchange has been the traditionally preferred method of divesture. The degree of actual transfer via stock listings has been limited for a number of reasons, including the fledgling developmental stage of the capital markets with limited absorptive capacity.

Despite the increasing amount of share sales to the public, the state has maintained sizeable ownership and involvement in the operation of these enterprises in both Malaysia and Indonesia. Total "privatization" in the western sense is a rarity. Rather more accurately, many of these companies have been "corporatized"; through the issuing of shares to the public and the replacement of a bureaucratic board of directors with a new private sector board, these companies have been restructured as private entities. Malaysian Airline System (MAS) was the first

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[32] V.V. Ramanadham, ed., Privatization in Developing Countries, (London, Routledge, 1989), p. 410.

government agency in Malaysia to be privatized through the public flotation of 30% of its equity. However, despite partial privatization in share ownership, the central bank, Bank Negara, continues to hold a 52% interest in MAS, and the state maintains control over the board and management.[33] Thus many of the former state enterprises have simply become private sector monopolies. Critics fear underlying goals of privatization, such as increased competition and accountability to non-governmental shareholders are being undercut by the state's continued involvement in corporatized enterprises.

Another common mode of privatization "Asian-style" has been the disbursement of contracts by the state to the private sector, particularly in the area of public works projects. This type of arrangement is distinctly different from the actual issuing of shares, and has been used as a means for cutting government expenditure on large expensive projects and for increasing private sector participation in an area of the economy previously off-limits. The contractor, often a member of the political elite, retains a stake in management and/or receives a cut of the profits. In Indonesia, a business group controlled by Suharto's daughter Siti Hadijanti Rukmana was awarded a substantial contract for building a major highway running through Jakarta. Her business group maintains management of the toll road and takes a slice of the profits. Her younger brother Tommy is also building a toll road in West Java. In Malaysia, on a grander scale, the M$6 billion contract for construction of the North-South Highway running the length of peninsular Malaysia was awarded to United Engineers Malaysia (UEM), at the time a poorly

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[33] Doug Tsuruoka, "Privatized Patronage", Far Eastern Economic Review, December 20, 1990, p. 43.

performing company with no track record in highway construction. UEM has also recently won a second M$1 billion contract to build a causeway linking Johor and Singapore as part of the "growth triangle" scheme joining Malaysia, Singapore and Indonesia. It should be noted that UEM is controlled by UMNO and the Prime Minister is a trustee of the company.

The awarding of Malaysia's biggest public works project to UEM still arouses resentment among much of the population as a blatant misuse of political patronage. Part of the resentment comes from the fact that there has been no public bidding on these projects, fueling charges of political favoritism. The government claims this is perfectly legitimate, in keeping with its bidding policy of "first come, first served", designed to reward private sector initiative and entrepreneurship. Without a competitive bidding process, few believe innovation and entrepreneurship are being fostered within the bumiputra community. The importance of the relationship between these contractors and the state is key in understanding the reconstitution of political power and will be returned to shortly. The awarding of these contracts as a form of privatization has created a new realm of patronage for politico-bureaucrats seeking to enhance their political and economic power base.

Privatization plans have proceeded more rapidly in Malaysia than Indonesia. A 'master plan' drawn up by a group of financial advisors, recently identified 246 public enterprises worth U.S. $5.9 billion with privatization potential. Though reliable information on privatized companies is difficult to obtain due to government policy not to disclose the names of successfully privatized entities, government figures reveal that 32 companies have currently been divested to the private sector.[34] Privatization has been partial and selective, with the government maintaining its position as major shareholder in most cases. Areas where state assets have been sold include the national airline MAS, the national shipping carrier Malaysian International Shipping Company (MISC), the container terminal at Port Klang, and the Department of Telecommunications recently restructured as the private company Syarikat Telecom Malaysia Berhad (STMB), yet still fully owned by the government. This maintenance of control by the government, coupled with the increasing transfer of assets and their reorganization under the ruling party UMNO, has raised question as to the government's commitment to reducing the state's hand in the economy and its motivation for doing so. Government divesture of some debt-laden enterprises has reduced the state's financial burden, transferring approximately M$7.45 billion of outstanding debt from the public to private sector.[35] Profitable public enterprises have been more popular among buyers and have been sold off rapidly, often heavily over subscribed due to underpricing of shares. Those public enterprises sustaining heavy losses concentrated in the heavy industry sector, and subject to government regulation and restrictions such as cement, steel, and forest products will no doubt remain in government hands. The Malaysian railways also falls into this category; the government has been unable to sell it off even at a substantially discounted price of M$1 million.

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[34] Montagu-Pollack, p. 32.

[35] Gomez, p. 14.

President Suharto first proposed the idea of privatizing some of Indonesia's 200 public enterprises, most of which have been financial losers, in 1986 following the oil crash. Yet not until April 1990 did the first government divesture occur with the sale of 70% of the struggling tire company Intirub to the Bimantara Citra Group, controlled by Suharto's son Bambang Trihatmodjo. From privatizations beginnings, questions have accompanied the selection process of prospective buyers and contract recipients. In the case of Intirub, three other business groups bid for the company's purchase, all larger and more experienced than Bimantara.

From the outset, Indonesia has taken a far more cautious approach to privatization than Malaysia. Most analysts agree that the primary obstacles to privatization are political. The state's role of operating public enterprises is enshrined in the constitution as one of the three pillars of the economy. However, the importance of Article 33 can be viewed from the perspective of the principles it espouses rather than the form of ownership of particular companies. The constitution stresses the principle of "Kekeluargaan" which Sukarno translated as "collectivism". The current trend is moving towards applying this concept to private companies.

Though privatization progress has been slow, the Finance Ministry has drafted guidelines to clarify the government's position. The Ministry has announced that 52 state enterprises may be prospective targets for privatization in the near future. The mode of divesture clearly favored by the Ministry is the selling of shares through the stock market. Government regulation requires that a company record two consecutive years of profit prior to listing shares. However, this requirement was recently waived for cement giant Indocement, controlled by Liem Sioe Liong's Salim group, unleashing a barrage of criticism against the state's willingness to bend the rules for a politically well-connected ally.

Given the "unhealthy" status of 2/3 of Indonesia's public enterprises, the Finance Ministry listed a number of possible options to rectify the maladies affecting the public sector: mergers with healthier state enterprises, splintering off of subsidiaries, hiring short-term private sector managers, listing shares on the stock exchange, and, in extreme cases, liquidation.[36] A further issue requiring consideration is which of these companies can pull in a profit when forced to operate in a competitive environment? It may prove difficult to push the sale of shares in a private company that previously struggled for its livelihood, even with government protection and privileges.

The existence of key state enterprises will continue. However, even those with staying power, straddling crucial sectors of the economy have become subject to increasing scrutiny in the desire to foster greater transparency within the system. Pertamina, representing Indonesia's quintessential state enterprise, has been undergoing gradual reform since its embarrassing financial crisis of the mid 1970's. For the first time, a civilian has been appointed to head the enterprise, signaling the end of two decades of military control and a major shift in government policy. Though Pertamina's role as the manager of oil resources is protected by the constitution,

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[36] Schwarz, "A Lame Duck Hunt", p. 72.

it clearly must speed the move towards more transparent management to safeguard continued foreign investment in the oil sector: 80% of Indonesia's oil is produced under contracts with foreign companies.[37] In order to continue growth within a public sector framework, efforts have been made to streamline Pertamina's employee base as well as its peripheral assets. Up to 20 of the company's joint-ventures not directly related to the hydrocarbon industry may be sold off. Production sharing contracts with domestic companies have also been pursued, heralding a shift away from total reliance on foreign partners. However, critics charge as long as Pertamina remains an instrument of national economic strategy, inefficiencies will persist. 70% of Pertamina's total operations goes towards supplying oil for domestic consumption, a service for which the company is not allowed to take a profit.[38] This example illustrates the often inherent contradiction between pursuing social objectives and trying to run a profitable industry.

The move towards privatization has been hindered by a spate of problems which have slowed the pace of public sector dismantlement. The concept of privatization was not a consideration in most of the world's developing countries during earlier days of economic prosperity. The results of rapid expansion of the public sector in tandem with the economic realities of the 1980's have forced both Malaysia and Indonesia to implement divestment programs. The ideological underpinnings of national economic plans have had to keep pace with the new economic environment and create conditions conducive to a viable economy. The choice

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[37] Davies, p. 68.

[38] Ibid, p. 70.

of privatization has thus been made based on necessity and due to outside influences.

Problems of implementation abound. The institutional mechanisms necessary to support the privatization process remain underdeveloped. The size and level of development of the capital markets are inadequate for handling large equity sales, though it is anticipated the injection of new capital and players will strengthen the market over time. Privatization could result in up to US$1.8 billion of new equity being injected annually into the Kuala Lumpur Stock Exchange in the near future.[39] The Privatization Master Plan, released in February of this year, calls for the privatization of 37 public enterprises and projects over the next two years and the restructuring of 56 others. In light of the market's underdevelopment and limited absorptive capacity, this means companies may have to be sold to financially well-positioned foreigners and locals, namely Chinese business groups, which may be politically unacceptable and arouse nationalist sentiment. Because many public enterprises are money losers, divestment through capital markets may not be an option, as in Indonesia, where the law requires two years of consecutive profits prior to listing.

A further hinderance is the difficulty in establishing market value of an asset, exacerbated when governments do not follow generally accepted accounting procedures. Due to the lack of proper books of account, it took the Malaysian government 6 months to determine the value of the Department of Telecommunications before it could be corporatized as STMB. As a result

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[39] Doug Tsuruoka, "The Shares Scramble", Far Eastern Economic Review, December 20, 1990, p. 44.

of these problems, the newly formed STMB lost its first full year of profits due to the overvalued assets and undervalued debt it inherited.[40] These problems persist: In 1986, the newly privatized entity owed creditors M$500 million. As of 1990, that figure had escalated to nearly M$4 billion.[41]

The traditional importance of public enterprises' non-commercial objectives and the government's desire to perpetuate these goals after privatization have also slowed the transition. Promotion of social welfare and national development often run counter to the goal of turning a profit and thus intimidates would-be purchasers from saddling themselves with a money loser. If there is simply a shift of loses from the public to the private sector, serious doubts may be created as to the economic advantages of privatization, and the government may be compelled to offer continued subsidies and protection.

The government must also decide what businesses it wants to be in, something often not clear from its portfolio of assets. Critics have pointed to the haphazard implementation of privatization measures. While Indonesia has focused on trying to sell-off chronic money losers to reduce the state's financial burden, Malaysia has adopted a different strategy, selling off public enterprises as quickly as it can find buyers. This has resulted in the sale of the most profitable enterprises, leaving the state holding the money losers. This has been interpreted as

[40] Montagu-Pollack, p. 35.

[41] Tsuruoka, "Privatized Patronage", p. 43.

a greater long-term commitment to privatization on the part of Malaysia, regardless of the initial up-front costs.

There are also political constraints to be considered. Resistance from interest groups which stand to lose in the move towards privatization, means a lack of supportive, motivated participants. This applies to labor and management benefitting from employment, perks and influence, as well as politico-bureaucrats profiting from the public sector as a source of patronage and extra-budgetary financing. The government's reliance on public enterprise and protectionist policies has created a shortage of qualified, capable managers by hindering the emergence of entrepreneurship and managerial skills, talents needed to fuel the transition to a market based economy. This too has slowed the process.

In both Malaysia and Indonesia, public enterprise has traditionally been used as a counterweight to Chinese economic influence. In the move toward privatization, Chinese business conglomerates are best equipped to take advantage of the expanding opportunities presented by the shrinking public sector. This issue poses the greatest dilemma in Indonesia, where the indigenous population does not have the institutionalized protections of their counterparts in Malaysia. Though the Chinese possess the necessary capital and managerial skills to take over public enterprises, this may create significant political problems for the state. Malaysia has gotten around this obstacle by linking privatization to the objectives of the NEP. Public enterprises were initially created to assist the economic development of the Malay population, a basic tenet of the NEP. Within this framework, privatization is not politically viable unless it furthers the same goal. This change in rhetoric in favor of the private over public sector is justified by the state because "Bumiputra entrepreneurship and presence have greatly improved since the early days of the NEP and they are therefore capable of taking up their share of the privatized services."[42] However, this correlation between privatization and the NEP may have some debilitating effects on the success of the transformation from public to private enterprise as the pool of capable, financially endowed players is effectively reduced by limiting Chinese participation.

PRIVATE SECTOR GROWTH: ECONOMIC AND POLITICAL MOTIVATIONS

Who exactly are the significant players in the privatization process and how have they changed? These questions are inherently linked to the politics of privatization and its use as a means of legitimizing political ownership and control. The transformation of the economic order has necessitated the implementation of structural change and a reworking of the tools for maintaining political control and dominance. The need to rationalize the economic system, has posed a direct challenge to the perpetuation of the reigning political interests, long bolstered by an economic system which guaranteed a select few a disproportionate return.

Both Indonesia and Malaysia have experienced a reconstitution of the traditional economic players under private sector labels. These groups are operating more openly on their own behalf and actively participating in the process of capital accumulation. It is no longer simply "the

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[42] Ng Chee Yuen & Norbert Wagner, "Privatization and Deregulation in ASEAN, an Overview", ASEAN Economic Bulletin, March, 1989, p. 220.

state" operating in the name of the populace and the greater good, but subsets of the state attempting to establish their own autonomous economic base within the new economic order. Through expanded economic ownership, these groups have sought to strengthen and bolster their political position by forming an independent capital base which will provide clout and freedom beyond the volatility of the political system. This has led to increasing difficulty in distinguishing between the public and private domain, particularly differentiating between companies owned by politico-bureaucrats on behalf of political institutions versus those owned for their own private benefit.[43]

Heavy government involvement continues to prevail under the guise of private enterprise. There has been a transfer of economic patronage from the state to the ruling political party, UMNO, in Malaysia, and from the state to the ruling family in Indonesia. Close linkages between party politics, the bureaucracy and business have been maintained. Paul Cook, in his study of privatization in Malaysia, observes that within this complex, privatization is unlikely to be more than a rearrangement of economic and political power rather than any great change in the make-up of the complex. According to this theory, privatization represents a shifting of ownership within pre-existing power groups.[44] Yet as these rearrangements occur within traditional ruling elite groups, their economic power base has become broader and more autonomous, creating a foundation for viability beyond the existing political structure.

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[43] Richard Robison, "After the Gold Rush: the Politics of Economic Restructuring in Indonesia in the 1980's", Southeast Asia in the 1980's, (Sydney, Australia, Allen & Unwin Ltd., 1987), p. 345.

[44] Paul Cook and Colin Kirkpatrick, eds., Privatization in Less Developed Countries, (Sussex, England, Wheatsheaf Books, 1988), p. 253.

Public sector expansion was in part initiated to fill the gap created by the lack of an indigenous capitalist class capable of undertaking development and expansion of key economic sectors. In the 1980s and 90s, development of an indigenous entrepreneurial group has not reached the required levels to pick-up the slack created by the shrinking public sector and provide a counterweight to foreign and Chinese capital. This absence has been interpreted by both UMNO and the Suharto family as sufficient justification for their amplified economic involvement, masked behind the stated aim to assist indigenous participants gain a piece of the opportunities presented by privatization.

The nature of the political system has impacted significantly the growth of the key private sector players and their perceived role in the process of national development. The ideologies espoused by a democratic versus an authoritarian political system have determined the form of economic and political behavior deemed acceptable by a ruling elite. In Malaysia's democratic party system, it is the goal of the political elite to protect the party's position and assets in order to ensure its return to power in an election. Through ownership of an expanding array of multi-purpose holding companies with a wide range of business interests, UMNO has ensured its access to a growing pool of corporate assets to aide in its maintenance of political power. While business conglomerates throughout Asia thrive on government patronage, no group of companies owned outright by a political party have profited to such extent from government favor.[45] Conversely, in the authoritarian, military-dominated state of Indonesia, the overriding goal is to

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[45] Doug Tsuruoka, "UMNO's Money Machine", Far Eastern Economic Review, July 5, 1990, p. 48.

protect the position and assets of the ruler and the military. As a political elite, maintaining favorable patron-client ties which will guarantee privileged access and favorable treatment is the predominant goal, ensuring continued access to a piece of the economic pie.

The rapid growth of prominent corporate conglomerates and their respective nuclei of power is reflective of these contrasting political systems. The accepted parameters of corporate operation have traditionally been defined and developed as a product of political ideology and goals. Recently, political ideology has had to bow to overriding economic pressures necessitating the adoption of more efficient, transparent modes of economic organization and growth. The move towards privatization and the emergence of select groups of individual and political party interests as powerful owners of equity has been an important outcome of the political and economic transitions of the 1980's.

An array of political and economic factors constitute the primary motivations for the expanded economic role taken on by these groups in the move toward privatization and dismantlement of the public sector. The legitimacy of the state in both Malaysia and Indonesia has been bolstered by outstanding economic growth rates, which has mitigated public protest versus political repression and economic inequality. A controlled political forum was accepted by many in return for the opportunity to significantly improve one's economic position. The legitimacy of Suharto's New Order, as well as the UMNO party has been based on the promise of economic development, linking the stability of the political order to sustained growth. With the declining ability of the public sector to meet development goals, privatization has been adopted as a necessity for sustaining growth and ultimately, maintaining political stability and legitimacy.

In Malaysia, the UMNO party has fashioned itself as an agent of growth and national development. Its mandate has been founded on promoting the goals of the NEP and furthering the Malay economic position. The party's success in linking its objectives to those of the NEP as its modus operandi has given it the advantage of clearly stated, publicly accepted goals of development and equitable distribution as compared to the more nebulous unofficial promotion of pribumi rights in Indonesia. Based on its mandate to promote the rights of the majority, UMNO's reigning position is legitimate within the eyes of the populace which possesses the power of the vote to keep the party in check should it abuse it's position. As a champion of Malay rights, UMNO has gained Malay loyalty and, psychologically, has bolstered the Malay populations own sense of competence and self-worth. Some analysts have criticized the identification of the state with one segment of society, namely the Malays to the detriment of the Chinese and the Indians, as a factor undermining the state's legitimacy. Yet the bottom line rests on the fact that it is the Malay community which possesses political power, and thus catering to its interests remains the surest way to be voted back into office. Further criticism has been levied versus the state's increasing role in capital accumulation, particularly UMNO's expanding economic holdings, as undermining and contradicting the state's legitimation function.[46] However this analysis ignores the fact that UMNO's need for legitimacy within the formal state structure

[46] Taylor and Turton, p. 20.

lessens as it develops an autonomous financial base independent of the political system and justified by the NEP's goal to increase Malay corporate ownership. With the official expiration of the NEP last year, it remains to be seen how its successor, the Outline Perspective Plan for 1991-2000, to be announced in June of this year, will handle targets for racial distribution of wealth. Though short of its goal of placing 30% of Malaysia's corporate equity in the hands of indigenous Malays, the NEP has been largely responsible for an increase in bumiputra capital from 3% in 1970 to 25% in 1990. This has likely influenced Prime Minister Mahathir's recent stress on rapid economic growth at the expense of redistribution of wealth in favor of bumiputras, representing a potentially dramatic shift in government policy.[47]

The rapid economic growth experienced by Indonesia in the 1970's based on the oil boom, provided Suharto's New Order regime with a broad based stamp of legitimacy. Though the income gap between rich and poor increased, the base subsistence level of the poor also rose, mitigating cries of inequitable distribution. The recent moves toward trimming down the large, inefficient public sector has directly benefited a few privileged players who have parlayed close relationships with Suharto into vast corporate empires. Suharto's own family has been the most significant and visible benefactor. The proliferation of family owned conglomerates, particularly those of Suharto's children, are indisputably fueling economic development. Some analysts have gone so far as to say that Suharto's children have succeeded in breaking the bureaucratic stranglehold the state has traditionally held over key industries like petrochemicals, air transport,

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[47] Tsuruoka and Vatikiotis, p. 60.

public works construction, and television.[48] This may be the case, yet economists agree that these privileged business groups are hindering the entrepreneurial initiative of indigenous businessmen who have been squeezed out of the privatization process. Thus, companies such as the large conglomerates Bimantara and Humpuss, owned by two of Suharto's sons, are increasingly targets for hostility traditionally directed at the ethnic Chinese. The perceived excess and rapid economic gain of the Suharto family has increasingly come under fire, weakening the regime's legitimacy. Criticism of Suharto's betrayal of the revolutionary ethos which the nation was founded upon, and failure to distinguish between his family's interests and those of the state have become more prevalent. The transfer of patronage from the state to the ruling family does not command the degree of legitimacy and institutional protection as the transfer from state to political party, as in the case of Malaysia.

Politically, the power structure in both Indonesia and Malaysia is dependent upon the ability to generate and distribute patronage. The new and evolving economic players have had to develop new channels of access within their growing empires to replace the decline of the public sector. The underlying power of politico-bureaucrats has been based on their ability to use and allocate the benefits of political office. Pribumi and Chinese businessmen alike have depended on privileged access to concessions and contracts to fuel the growth of their business activities. Now, rather than entering into a partnership with the state, the goal is to seek profitable joint-ventures with these new agents of development able to use their political

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[48] Adam Schwarz and Jonathan Friedland, "No Mere Middlemen", Far Eastern Economic Review, August 23, 1990, p. 56.

connections to muscle in on newly profitable industries. UMNO has relied on patronage to award politically influential party members by appointing them as directors of the many companies controlled by UMNO. In Indonesia, political allies and cronies have been brought into the family-run conglomerates as partners, coming in on the ground floor of lucrative new industries. Critics charge that these conglomerates, whether operated by a political party or ruling family, are inhibiting technocratic efforts to recast the economy along more competitive, market based lines. The state's public support of economic deregulation and liberalization is undermined by its advocacy of conglomerate growth which is outside the legal regulatory system.

In spite of these criticisms, these new economic players, in following in the footsteps of their predecessors, are likely to remain dependent on patronage to fuel their growth in the near future. It is impossible to restructure the system overnight; patronage and the importance of connections is a vestige of the old that is likely to remain a prevalent part of doing business in the 1990s. In responding to criticism that the Suharto family conglomerate Humpuss, run by 28 year old Tommy Suharto, was only invited to participate in joint venture projects to facilitate government approvals, a senior Humpuss executive replied,

> In Indonesia, who you know is important but that is true in New York, too. People with good information and good relationships have the right to make the best of what they have. We have done an outstanding job in technical marketing. We want to become an industrial company solving the future problems of Indonesia.[49]

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[49] Ibid, p. 59.

This desire to become viable and recognized contributors in the process of economic development, above and beyond association with a political party or family, is an increasingly common theme which may gain credibility with the passage of time.

Politically, a number of very tangible motivating factors have driven the trend toward privatization. The sale of assets to the private sector has strengthened the financing of the remaining public sector enterprises as well as filling government coffers. In Malaysia, privatization has directly benefited UMNO in its continual quest to target funding sources for the political machine. Though officially UMNO owns no shares in any company, it exercises control over a vast empire through politically connected allies who own shares and occupy the position of director in over 100 companies. It is speculated that the total value of shares owned on behalf of UMNO is approximately US$1.5 billion.[50] The party's property holdings could be worth an equal amount. UMNO is particularly meticulous about covering its tracks when its business dealings relate to election fund-raising. Due to the use of corporate nominees and complicated share swaps such as the recent Renong deal in which the party's corporate assets were restructured and consolidated raising M$440 million in the process, it is difficult to follow the trail of corporate maneuvers. UMNO has relied on cashless share swaps since the more desperate recession days of the mid-1980s as an inexpensive means for raising funds and gaining control of companies. The Renong deal represents the most complicated and sizeable swap to date and has resulted in the creation of a conglomerate controlling 8 major publicly listed companies and

[50] Tsuruoka, "UMNO's Money Machine", p. 48.

a number of private companies. Further maneuvering has led to Renong's recent acquisition of the hotel and property company the Faber Group, UEM, and TV3. Party supporters claim that the Renong deal illustrates UMNO's commitment to running its corporate assets more efficiently and profitably. One source close to UMNO is quoted as saying the Renong restructuring does the "job of tidying up the party's assets and improving corporate efficiency."[51] This remains to be seen, yet it has indisputably provided a valuable source of funds for the party. Opposition leaders, fearful of UMNO's growing power and their inability to fight a financial powerhouse at the polls, charge that the party's expanding assets will be used to return the party to power. Others point to conflict of interest due to the concentration of sensitive assets in the hands of the leading partner in government.

Indigenous Malay economic ownership remains a sensitive political issue in both Malaysia and Indonesia. Privatization has been espoused by both governments as a means of boosting the indigenous economic share, and correcting the imbalance between political and economic influence. Though the primary players in this process in Indonesia have been Suharto's children, they still are native pribumi, and as such are raising indigenous economic ownership. Suharto has stated publicly that his children, as young indigenous entrepreneurs, deserve the chance to amass the wealth and economic power that has traditionally remained in the hands of the Chinese. Additionally, his children are training other pribumis in business and providing them with opportunities. For many, it is difficult to overlook the speculation that nearly 80% of all

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[51] Ibid, p. 50.

government projects go in some form or another to Suharto's children or cronies, even if they are pribumi. This will remain a thorny issue until the sheer size of these conglomerates requires the hiring of significant numbers of Indonesians outside of the inner palace circle, a trend which has already begun. If staffing and management continue to progress along rational lines based on merit, an important and necessary degree of legitimacy will be gained.

The NEP's goal to promote Malay ownership has been closely linked with privatization measures in Malaysia. The sale of stakes in state-owned companies has enabled the government to divest ownership to the Bumiputra community within a controlled setting in keeping with the stated national goals of the NEP. In October of 1990, the Director-General of the government's Economic Planning Unit said that privatization was part of a national effort to nurture the country's bumiputra business community and stimulate the supply of capable bumiputra managers. UMNO's rationale for rapid corporate expansion has rested on the need to expand Malay ownership, however critics charge the NEP has been exploited by UMNO for its own personal aggrandizement. Since UMNO's first corporate acquisition in 1972 with the purchase of the New Straits Times Press, it has moved into an array of businesses spanning all sectors of the economy from telecommunications, to banking, to construction. The NEP's 30% bumiputra ownership requirement in privatization projects has provided an ideal means for UMNO leaders and well-connected Malay businessmen to gain control of valuable corporate assets. Some see a growing contradiction between the state's supposed goal to decrease its role in the economy and the increasing business interests of the ruling party. UMNO defenders claim the most important result is the expansion of Malay economic participation and the growing power they will be able to command through access to a common pool of equity. UMNO, in turn, as the perceived advocate of Malay rights, can depend on a pool of supporters at the polls who will return them to office.

Just as UMNO has used privatization to aide in its efforts to retain political control and establish an economic base, Suharto has used privatization to entrench his family's position in the face of uncertainty over political succession. The looming prospect of political change has provided an incentive for expansion of the traditional power base out of the palace and into the marketplace. With the potential decline of the family's political influence, if and when Suharto retires, the need to establish an independent corporate base outside of the parameters of office has escalated. Suharto, by assuring his children's continued accumulation of capital, and development of businesses and industries which make-up indispensable pillars of the economy, is protecting their position beyond the present political era. During Suharto's remaining time in office, there is a great need for these family and crony owned conglomerates to prove their technical and managerial capabilities, and overall economic viability beyond their access to patronage, to enhance legitimacy in the eyes of a critical public. Though conglomerates such as Bimantara, Humpuss and Liem Sioe Liong's Salim group achieved their prominent positions through political patronage and preferential access, their extensive economic holdings have enabled them to develop an independent capital base which may soon free them from the need to depend on patronage. The test will be if they can survive and compete in the marketplace without the benefits of patronage, and conversely, if Suharto remains in power, will they have to?

Many Indonesians feel that the still nascent and vulnerable stage of the family's expanding economic holdings will serve as inducement for Suharto to retain power in the near future, if only to protect his children.[52] A peaceful transition of power, never experienced during the Republic's history, may be influenced by the kinds of guarantees provided to protect both family and crony business interests. However, the more rapidly these businesses are able to establish economic independence, the greater their chances for survival regardless of who is occupying the presidential palace. Greater transparency on the part of the government toward privatization, and more regularized implementation of privatization measures involving a wider spectrum of players will also strengthen the position of these family businesses.

In both Malaysia and Indonesia, the primary political players have actively sought to lessen their dependence on the state apparatus and create a more autonomous power base to ensure their livelihood beyond the fluctuations of the political system. With UMNO's and the Suharto family's expanding role in the economy, it becomes more difficult to simply cast them aside if and when they fall out of political favor. This entrenchment of political elites as indispensable players in the accumulation of domestic capital and the ability to spread the fruits of this growth to a broader societal base, will enhance the long-term viability of those holding power. In the 1980s and 90s continued economic growth in tandem with decreased formal state ownership has provided a means for the political elite in Malaysia and Indonesia to strengthen their power base and augment their position. Privatization has provided an easily manipulated

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[52] Steven Erlanger, "For Suharto, His Heirs are Key to Life After '93", The New York Times, November 11, 1990, Section L, p. 12.

means to this end, and a vehicle for initiating the reconstitution of the traditional power base from the presidential palace to the marketplace.

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